The Heritage Foundation 214 Massachusetts Avenue, N.E. Washington, D.C. 20002-4999 (202) 546-4400

Congressional Testimony

Opportunities for Private Sector Participation in Surface Transportation Investment and Operations

Testimony before House Committee on Government Reform Subcommittee on Energy Policy, Natural Resources, and Regulatory Affairs

May 18, 2004

Ronald D. Utt, Ph.D.
Herbert and Joyce Morgan Senior Research Fellow
The Heritage Foundation

Mr. Chairman and Members of the Subcommittee:

My name is Ronald D. Utt. I am the Herbert and Joyce Morgan Senior Research Fellow at the Heritage Foundation where I conduct research in the areas of transportation, housing, community development, privatization, federal budget issues and public/private partnerships for infrastructure investment. It is an honor and a privilege to appear before the Subcommittee today to discuss opportunities for the public sector to work co-operatively with the private sector to harness the resources, talents and creativity of the competitive market place to improve surface transportation services in the United States. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

From the Colonial era through the middle of the twentieth century, private sector participation in America's transportation system was extensive, and in many areas provided a much larger share of the service in comparison to today's level of involvement. Beginning in colonial times and continuing through independence, private toll roads – the Lancaster Turnpike being one of the most notable -- were organized by private investors in many parts of the country. They co-existed with a number of federally sponsored roads such as the Natchez Trace and the Cumberland Road, and the Federal Road connecting New Orleans with the Atlantic seaboard.

Many ferry services were organized as private businesses, as were freight and passenger railroads, many with government support, as was the case with land grants to spur western railroad development and create a transcontinental system. Late in the nineteenth century as the Industrial Revolution led to concentrations of workers and businesses in large cities, private urban transit systems beginning with horse-drawn omnibuses emerged, and soon evolved into electric rail, trolley and bus systems.

But as time passed, road building became increasingly concentrated under public control, and beginning in the years after World War II competition from autos and declining ridership left many private transit systems in financial trouble. In the years ahead, most were taken over by public authorities in order to preserve service. Likewise for many private ferry systems. And in the early 1970s private passenger rail service was consolidated into the publicly operated Amtrak system.

Similar trends occurred in Europe over the same period as the public sector became more active in the acquisition, development and operation of most surface transportation services. But beginning in the 1980s, and largely due to increasingly severe limits on public sector spending growth, countries in Asia and Europe began looking for alternative ways to control transportation costs and to finance improvements and capacity additions. In the process, many turned to private sector partners and/or investors to provide the funds and the cost saving management.

Beginning with the privatization of many of Japan's passenger rail lines in the 1980s and 1990s, one country after another began to increase its reliance on private sector partners. The London bus system is now contracted out to private operators, some Japanese passenger rail service is owned and operated by private investors, and the private sector operates the passenger rail systems in Britain, Argentina and elsewhere. Similarly, privately financed and owned highways are becoming more common in Europe and Asia. While America recognizes the Benetton company as a leading manufacturer and retailer of clothing, many Italians recognize it as the largest owner of highways in that nation.

Although many countries in Europe and Asia are well ahead of the United States in creating innovative financing arrangements for transportation infrastructure, we have the advantage of being able to learn from their successes and failures, and as a result, are beginning to close the gap. And with the likelihood that future public revenues for transportation will be severely limited in the near future, partnerships with the private sector are certain to increase at a rapid rate, especially at the state level where a number of major partnerships projects are under consideration.

Developments at the Federal Level and Bipartisan Presidential Endorsements

The reauthorization process for the expired TEA-21 has been characterized by a number of proposals to allow for greater private sector participation in surface transportation. The President's proposal included money to encourage and study partnership opportunities for highways, and legislation to extend the use of tax exempt private activity bonds to highway construction. The bond proposal was also included in the Senate's plan, while the House bill contains a toll express lane proposal that would allow for private sector participation in such capacity additions. Although the prospect for a new highway bill is uncertain at this time, and its final contents unknown, it is likely that funding constraints will move it in the direction of more reliance on private-public partnerships.

Importantly, and long before the development of the new highway bill, two recent U.S. Presidents have issued executive orders (that are still in effect) to encourage and permit private sector involvement with infrastructure investment. On April 30, 1992 President George W. H. Bush signed Executive Order 12803 to encourage infrastructure privatization:

- Section 2 (b) of the order states that "Private enterprise and competitively driven improvements are the foundation of our nation's economy and economic growth. Federal financing of infrastructure assets should not act as a barrier to the achievement of economic efficiencies through additional private market financing or competitive practices, or both."

- And Section 3 states "To the extent permitted by law, the head of each executive department and agency shall undertake…to modify those

procedures to encourage appropriate privatization of such assets consistent with this order…"

On January 26, 1994 President William Clinton issued Executive Order 12893 titled "Principles for Infrastructure Investment".

- Private involvement was encouraged by Section 2(c) which states that "Agencies shall seek private sector participation in infrastructure investment and management. Innovative public-private initiatives can bring about greater private sector participation in the ownership, financing, construction, and operation of the infrastructure programs referred to in Section 1 of this order. Consistent with the public interest, agencies should work with State and local entities to minimize legal and regulatory barriers to private sector participation in the provision of infrastructure facilities and services."

Despite these bipartisan endorsements from two recent presidents and executive orders that require executive branch agencies to adopt policies to facilitate private sector investment in infrastructure such as highways and passenger rail, little has been done to implement these good intentions.

International Experience: Private Roads in Europe and Asia.

In contrast to the handful of U.S. private road projects built or proposed, a number of European and Asian countries have moved aggressively to implement privatized road projects with government's encouragement or cooperation. Beginning in 1995, Italy began selling to the investing public and to private investors shares in Autostrada SpA., until then a state-owned corporation going back to the Mussolini era. Autostrada operates 1,780 miles of toll roads in Italy, about half the roadway mileage of the country. With revenues of some $2 billion per year, Autostrada is now fully owned by investors and its stock is actively traded on European exchanges. The Benetton retail group is the largest shareholder.

In 2000, the Canadian province of Ontario sold its toll road Highway 407 –ETR, which serves the Toronto metropolitan area for an estimated $2 billion. Tolls are collected either electronically by an electronic debit card mounted in the car, or by a photo that matches license plate with owner, who is subsequently billed by mail. Either way, users are not slowed by having to stop at a toll booth.

In the Peoples Republic of China a modern highway system is being built entirely using toll financing, most commonly with toll authorities established by cities and provincial governments in partnership with private investors. Japan is actively considering the sale of its government-owned toll roads based upon campaign commitments by its Prime Minister Junichiro Koizumi. Australia uses the private sector to compete to build and operate its inter-city toll roads in accordance with plans developed by government transportation departments.

By utilizing the skills and resources of the private sector, countries in Europe and Asia have been able to expand and improve their surface transportation infrastructures in response to rising use. These expansions have been accomplished at little cost to the taxpayer or to government budgets because tolls paid by motorists fund the roads.

Recent United States Experience

Although private and private/public toll roads are becoming common in Europe, the U.S. has only a few privately financed and privately owned and/or operated toll roads and bridges. One of the oldest is the Ambassador Bridge connecting Detroit with Windsor, Canada, which has been in operation since the 1930s and serves an estimated 10,000 trucks per day, as well as thousands of autos. Another private venture spanning the northern border is the newer Detroit/Windsor Tunnel, privately owned by a separate investor group. Of the more recently completed private toll roads, the oldest is the Dulles Greenway in Northern Virginia, completed in 1995. The Greenway picks up where the public toll road ends at Dulles airport and extends service west into Loudoun County. The Greenway has since been joined by the Greenville Southern Connector, a private not-for-profit venture in South Carolina, the Pocahontas Parkway near Richmond, Virginia, and the Camino-Columbia Toll Road near Laredo, Texas. Getting under way in California is the construction of the San Miguel Parkway in the San Diego area (California State Route 125).

In addition to these general purpose toll roads are a number of "toll express" lanes that supplement existing public highways. In the Los Angeles area, the Route 91 toll express lanes were privately financed and built and operated successfully from 1995 to 2002. Many more such projects are contemplated, and summarized below are a few of the notable endeavors being discussed in several states.

Virginia: Virginia has enacted one of the most accommodative public-private partnership laws to encourage qualified private sector enterprises to propose to the state transportation department (VDOT) partnership opportunities for investment in new road or transit capacity. Originally enacted in 1988 to permit the construction of a specific, privately financed, built and operated toll road in Loudoun County – the Dulles Greenway, the law was subsequently amended in 1995 to allow any qualified partnerships to be proposed for eligible projects throughout the state. In response to the wide scope the law allowed, a private company proposed to use a partnership arrangement with VDOT to fund and build the Pocahontas Parkway in the Richmond Virginia area. In 1995 another proposal was received from a private company to take over the maintenance duties on a portion of Virginia's interstate highways**.**

The Parkway was completed in 2002 – fifteen years ahead of the state's funding schedule, and the tolls charged to users are sufficient to service the debt issued to build the road and the cost incurred to operate and maintain it. Although the project was presented to the state by a private builder, and was built in partnership, it is owned by the

not-for-profit created jointly by the state and the developer to issue the bonds and collect the tolls. In turn, the not-for profit is owned by VDOT. The interstate maintenance contract is still in effect today, and the contractor that performs the work has since been hired to provide the same services in the District of Columbia.

More recently, and largely a consequence of limitations on future state and federal highway funding, a number of new partnership proposals have been presented to VDOT. Over the past fifteen months, VDOT has received five separate proposals to add capacity on three interstate segments, and a sixth proposal is being developed to aid in the construction of the proposed rail line to connect Dulles Airport with the existing Metro system. These proposed projects include:

Two proposals – one for $5.9 billion the other for $6.3 billion -- from qualified design and build consortiums have been received to toll and reconstruct the 325 mile I-81. I-81 serves as a major north-south interstate shipping route, and heavy truck and car traffic combines to increase congestion, diminish safety, and wear down the roadbed. One proposal would create a toll express lane limited to trucks. In return for less congested travel, trucks would pay a toll that would help offset part of the cost of constructing the new lanes.

Two proposals have also been received to widen and extend the existing HOV lane located in the median of I-95 between the Potomac River at Washington DC and southern Prince William County. Both plans propose to turn the HOV lane into a HOT lane (High Occupancy/Toll), and use the tolls collected on single occupant vehicles to service the debt issued to expand capacity. One plan would spend an estimated $500 million to widen the road from two to three lanes from the intersection with the beltway south, and extend the lanes another 20 miles south to a point just north of the city of Fredericksburg. The second proposal – estimated to cost a billion dollars -- would add the additional lane from the District of Columbia south, and extend the terminus of the HOT lane to a point just south of the city of Fredericksburg.

Finally, one proposal – estimated to cost more than $600 million -- has been received to add HOT lanes to the very congested portion of the Virginia side of the beltway. The new lanes would be built on the beltway from the Dulles toll road south and east to where I-495 intersects with I-95 South at the Springfield interchange. Because of the extensive bridge and interchange work this route would entail, some estimate that tolls would only cover a portion the debt service costs and that funds may also be required from the state to complete the project.

With Virginia's highway upgrade plans moving to a final decision, public officials in Maryland have been discussing their participation in the beltway upgrade and expansion, and in May, 2004 Maryland's Secretary of Transportation announced plans to create a statewide system of toll-financed express lanes. One of those corridors was the Maryland portion of the I-95 beltway, presumably from one Potomac River crossing to the other, for a total distance of more than twice that contemplated on the Virginia side. At an estimated cost of $2.3 billion, Maryland believes that tolls would have to be paid by all

users, and that car pools wouldn't be able ride for free or at a reduced rates because the state couldn't afford to forego the revenue. As such, the Maryland plan for I-95 beltway is for toll express lanes rather than HOT lanes.

In contrast to Virginia, Maryland law does not permit private/public partnerships for roads, so the state, or some public entity created to oversee and operate the project, would be required to fund these projects in their entirety. An effort had been made several years ago to enact partnership legislation but that effort failed. A toll express lane could also be built on the western portion of the Baltimore Beltway (I-695) from where it connects with I-95 in the south and north of the city. The estimated $1.2 billion cost of the new express lane could be offset with tolls.

The construction of the long-discussed Inter County Connector (ICC) – running east/west in the Maryland suburbs of Washington, DC and connecting I 270 (at Gaithersburg) with I-95 about eighteen miles to the east – is expected to cost as much as $1.7 billion, and the state believes that tolls on the new road can offset some of the costs. One proposal suggests that tolls could support $450 million in borrowing, $600 million would come from GARVEE bonds, while $150 would come out of the state's transportation trust fund.

Thanks to its PPP law, Virginia has the opportunity to access as much as $8.2 billion in private-sector-supported road investment, while Maryland, without such a law, would have to tap into some part of the public treasury to fund the prospective $5.2 billion that it's new projects would cost.

Minnesota: In late December, 2003, Governor Tim Pawlenty of Minnesota unveiled a new plan to "form public-private partnerships to widen state highways and pay for the projects with a toll system". He promised that in 2004 the Minnesota DOT will issue formal requests for interest from private-contractors to finance and build additional lanes in the Minneapolis-St. Paul area of the state. Although no cost estimates were provided, the governor lists six potential corridors in the congested Twin Cities area that would be considered for capacity expansion by way of new toll express lanes built and financed in partnership with private investors/developers. These include:

- Interstate 35W through much of the metro area.
- Interstate 94 from downtown Minneapolis to Woodbury.
- Interstate 394 in the western suburbs.
- Large sections of the Interstate 494 and 694 beltway.
- Interstate 35E from St. Paul to the north.
- Large portions of U.S. 10, U.S. 169 and Minnesota Highway 36.

Facilitating Minnesota's greater emphasis on the use of partnership toll roads for capacity expansion is a 1993 state law that allows Minnesota to engage in such arrangements. Although the law has been on the books for more than ten years, these six projects would be the first undertaken in the state under the law. In the recent past, political opposition to new road construction and ample fuel tax revenues deterred the use of this innovative approach. But since 2002, a change in political leadership in the state and budgetary shortfalls have encouraged the state to consider more road construction and seek alternative revenue sources to fund them.

Georgia: In November 2003 Georgia finalized and implemented a public-private transportation partnership act modeled after Virginia's 1995 Act. In January, 2004, the state received its first partnership proposal from a consortium of Georgia road builders – called the Parkway Group, which in turn was organized by the Washington Group -- to fund and construct a new 39 mile toll road connecting I 85 in the northeastern Atlanta suburbs with the university town of Athens in the west. The new road would essentially substitute for the congested and accident-afflicted GA 316 that now connects the two cities.

Absent the proposal from the Parkway Group, Georgia DOT's future plans for Ga. 316 were limited to a series of intersection improvements scheduled to take place over the next 30 years. Instead, if a partnership agreement can be reached between the state and the consortium, the new road could be opened by 2011.

Estimated to cost about one billion dollars, preliminary press reports indicate that the Parkway Group would borrow the funds and build the road, and then relinquish ownership, possibly to a not-for-profit operator that would operate the road, charge tolls and service the debt. Because the partnership law permits a measure of confidentiality regarding many of the details of the proposal, it is not clear at this point whether the project is just a design-build proposal or would involve the creation of a not-for-profit operator by the Parkway Group.

Wisconsin: In August, 2003, Wisconsin's Secretary of Transportation proposed to state legislators that a system of electronic tolls be implemented to fund the estimated $6.2 billion worth of repairs, improvements and expansion of Milwaukee's freeway system. Wisconsin is one of 18 states with public-private partnership laws, and some or all of the projects were proposed as part of it. Under the secretary's plan, all 270 miles of the system would be improved, and 127 miles of that amount would have new lanes added to increase capacity and reduce congestion. Among the affected roads would be I 94, I 43, and I –794. At the same time, a former state legislator testified in favor of $810 million dollar toll financed, privately-funded partnership project for Milwaukee's Marquette Interchange.

Among the chief reasons for the proposal was the need to repair Milwaukee's aging and congested freeways, and the absence of any money in the department's budget to fund them. Although Wisconsin's fuel tax, at 27.3 cents per gallon, is the highest in the

nation, there are no funds available for these and other costly road projects throughout the state.

Wisconsin's law allows for tolled roads, but none have been built because of political opposition, which the secretary's proposal appears to have re-ignited. Political leaders in Milwaukee opposed the plan, and in response, the governor announced that he could not support it, but did leave the door open to using tolls for future capacity-enhancement projects.

Competitive Contracting Opportunities in Transit

In recent years, many transit systems have seen costs rise faster than revenues, leading to wider deficits and deeper public subsidies. But as state and local governments confront growing deficits in their own budgets, many transit systems have been raising fares frequently, and by large percentage increases. While fare increases and service reductions have been the response in many transit operations, several public systems here and abroad have turned to some form of competitive contracting with private sector operators to reduce costs and increase efficiencies. Information included in this section is summarized and updated from a lengthier 2000 Heritage report titled "Competition, Not Monopolies, Can Improve Public Transit".

The first large conversion of transit service to competitive contracting occurred in San Diego in the early 1980s. It might be expected that in the United States, with the world's strongest market economy, competitive contracting would have spread rapidly. However, the greatest progress toward incorporating competition in transit has occurred overseas.

International Experience

While most public transit service in North America is provided by government owned operators, the situation is considerably different in other parts of the world. Throughout the low-income world, most public transit is provided by private operators (except in former communist nations), without either capital or operating subsidy. In high and middle income Asia (Japan, Hong Kong, Singapore, Taiwan and South Korea), most rail and bus public transit service is owned and operated by the private sector and there is virtually no capital or operating subsidy. This includes the privately operated rail systems in the Tokyo-Yokohama area, which carry more passengers than all of the transit services in the United States. And, increasingly, transit services are being converted to competitive contracting elsewhere in the high-income world.

Some of the more successful conversion programs have been in London, Copenhagen and Stockholm.

London: Transport for London (formerly London Transport) manages the largest bus system in the world, with more than 6,000 vehicles (service area population: 7 million). From 1970 to 1985, bus costs per vehicle mile had risen 79 percent. In response, the British parliament enacted legislation that led to conversion of the entire bus system to

competitive contracting. By 1999, the conversion had been completed. The results are as follows:

- Costs per vehicle mile were reduced 48 percent from 1985 to 2001 (inflation adjusted).

- Overall annual expenditures, capital and operating, dropped 26 percent.

- Despite the lower expenditures, the lower operating costs per mile permitted service to be expanded 26 percent.

- Productivity --- measured by the level of service produced per unit of currency rose 91 percent, or 4.1 percent annually.

Eventually, the public monopoly transit assets were sold, generally at the operating division level, to the private sector, so that virtually all London service is provided by private carriers under competitive contract. But, before this sale, the public monopoly operator tended to improve its service quality on routes that it was awarded under competitive contracts. Through the years of competitive contracting, London Transport bus service has continued to be of high quality. Ridership has increase 30 percent since competitive contracting began, and is now at its highest point since the 1960s. At more than 1.5 billion annual boardings, London bus ridership is 1.5 times that of the New York City Transit Authority, which has a larger service area and is by far the largest bus operator in the United States.

If London Transport costs had continued at the rate prior to competitive contracting, the operated service levels would have required expenditure of $12 billion more over the past 16 years.

Copenhagen: The Danish parliament required public transit bus services in Copenhagen to begin conversion to competitive contracting in 1989. Copenhagen is Denmark's largest metropolitan area, with a population of 1.5 million, somewhat smaller than metropolitan Orlando. The transit authority has a system with approximately 1,200 buses and annual ridership is approximately 260 million (more than all US transit systems except for New York, Los Angeles and Chicago). Because of a fear that the transit authority could not objectively evaluate proposals by private companies and its own internal operating department, the legislation did not allow the transit authority to compete for contracts. Later, the public bus operating division was sold to the private sector, and the prohibition was lifted, since there would be no possibility of a conflict of interest on the part of the transit authority in evaluating proposals. The conversion of all bus services was completed in 1995.

- Costs per vehicle mile were reduced 24 percent from 1989 to 1999. Overall capital and operating expenses declined eight percent from 1990, while service was expanded 14 percent. Management estimated savings at approximately $250 million through 1999. The productivity improvement has been 32.2 percent.

- Ridership has risen nine percent after years of decline. Management attributes the higher ridership to expanded service levels from more cost efficient operations and high service quality.

Stockholm: An act of the Swedish parliament led to conversion of virtually all public transit service (bus and rail) in Sweden. Stockholm is Sweden's largest metropolitan area, with a population of 1.8 million, approximately the same as metropolitan Orlando. The Stockholm transit system has 1,700 buses and 1,200 rail cars, including a subway that carries more riders than the Washington Metro. Stockholm carries 600 million boardings annually --- approximately the same ridership as all of the transit services in the Chicago, Los Angeles or San Jose-San Francisco metropolitan areas. During the 1990s, the conversion of all bus and rail service (subway, light rail and commuter rail) to competitive contracting was accomplished in Stockholm.

From 1991 to 1999, costs per vehicle mile were reduced 20 percent. Overall capital and operating expenses declined seven percent, while service was expanded 16 percent. If costs had continued to rise at the rate of inflation, an additional $900 million would have been required. The productivity improvement has been 25.0 percent.

Elsewhere: Bus systems have been competitively contracted in Adelaide and Perth, Australia. New Zealand implemented a national conversion to competitive contracting in 1991, while South Africa is beginning a similar conversion. In all cases, substantial cost savings have been achieved. The impetus for each of these conversions has come from national or state parliaments. The European Union is in the process of developing regulations for mandatory conversion of public transit systems in Europe. This conversion process is expected to take many years, but bus and rail services are already being competitively contracted in France, Belgium, Finland, Poland, Germany and Italy.

COMPETITIVE CONTRACTING IN THE UNITED STATES

US public transit competitive contracting began with the para-transit (door to door) services added during the 1960s and 1970s. These services were principally designed for senior citizens and the disabled. The quickest way to start these services was to seek competitive bids from the private sector. Today, 69 percent of para-transit services are provided through competitive mechanisms. Overall, approximately nine percent of transit bus service is competitively contracted in the United States.

San Diego, Denver and Las Vegas represent perhaps the most significant cases. In all three locations, there has been a strong commitment at the top policy level to competitive contracting. In San Diego, the transit policy organization, the Metropolitan Transit Development Board and local jurisdictions have pursued a deliberate policy of using competition. The impetus in Denver came from the Colorado state legislature, which passed landmark legislation requiring 20 percent of bus service to be competitively contracted in 1988, and has since more than doubled the requirement in two separate acts.

In Las Vegas, the transit authority established a new system in the early 1990s and recognized that it could carry many more passengers if unit costs were minimized.

San Diego: San Diego began what became the first of the world's major transit competitive contracting programs in 1980, five years before London Transport. The impetus was escalating costs. Between 1968 and 1979, new transit subsidies had permitted the service to be substantially expanded, but costs had risen even more. After adjusting for inflation, costs per service hour rose 49 percent from 1968 to 1979. By 2001, 44 percent of bus services were competitively contracted. The conversion was gradual enough that no public transit employee layoffs were required.

Cost savings have been substantial. As of 2001, competitively contracted costs were 40 percent lower per mile than non-competitive costs. If costs had continued at the pre-competitive contracting 1979 rate (inflation adjusted), San Diego would have needed to spend $500 million more to produce the same amount of service through 2002.

But the greatest cost impact has been on the services still provided non-competitively. In the new competitive environment, San Diego Transit has been able to control its operating costs much more successfully. "Ripple effect" savings, the impact of competition on the costs of internally produced transit service, have reduced San Diego Transit's costs 16 percent (inflation adjusted) since 1979. By contrast, over the same period, US public transit operating costs per mile rose four percent. The following results were achieved from 1979 to 2001:

- Overall costs per mile were reduced 30 percent (inflation adjusted).
- Overall annual operating expenditures increased 20 percent.
- Service was expanded substantially more, 72 percent.
- Productivity rose 43 percent, or 1.6 percent annually.

Bus ridership has risen 50 percent. This is a considerable increase, in view of the fact that three light rail lines opened during the period, and replaced some of the most productive bus services in the area.

The impact on subsidies has been even greater. With the competitive contacting program, San Diego bus subsidies were $59 million in 2001. If the competitive cost improvements had not occurred, the same level of bus service would have required $103 million in subsidies in 2001. Thus, competition has been associated with a 43 percent lower level of subsidy overall.

Denver: In 1988, the Colorado legislature enacted the nation's only public service mandatory competitive contracting law. The act required Denver's public transit authority, the Regional Transportation District (RTD), to competitively contract 20 percent of its bus service within an 18-month period. The success of the program led to

an expansion of the legislative mandate to 35 percent and 50 percent in 2003. Both of the competitive contracting expansions were signed into law by Governor Bill Owens, who had been legislative co-author of the original 20 percent mandate in 1988. During 2002, 38 percent of bus service was provided through competitive contracting. During 2004, that amount will rise to 44 percent, with the mandated additional six percent accounted for by the competitively contracted demand responsive services.

As of 2002, competitively contracted bus costs were 48 percent lower than non-competitive costs. If costs had continued at the pre-competitive contracting 1988 rate (inflation adjusted), Denver would have needed to spend $550 million more to produce the same amount of service through 2002.

Competitive contracting has been associated with a substantial improvement in RTD's overall productivity.

- Before competitive contracting (1978 to 1988), RTD's operating expenditures rose 16 percent, while its service level was reduced 13 percent. Costs per service hour increased 33 percent, and overall productivity (service per dollar) declined 2.8 percent annually.

- From 1988 (the last year before competitive contracting) to 2002, RTD operating expenditures rose 32 percent, while service levels were increased 90 percent. Costs per service hour declined 30 percent and there has been a 2.6 percent annual increase in productivity. RTD has recovered virtually all of the productivity losses of the pre-competitive contracting period.

Over the period, Denver's bus ridership increased 36 percent. As in San Diego, this is a considerable increase, because the transit agency opened a light rail line during the period, which replaced some productive bus services.

Denver represents the only case in the United States in which the rate of competitive contracting exceeded the rate of employee attrition. The 1988 legislation required RTD to achieve the 20 percent competitive contracting mandate without laying off any employees. As a result, RTD kept excess labor on staff. RTD employed skillful human resources techniques to minimize these extra costs, which were modest. Excess labor compensation peaked at approximately three percent of annual costs. Overall, excess labor compensation was estimated at 1.2 percent over a seven-year period. The approach of keeping excess staff on the payroll, rather than laying off employees removed any potential liability for labor protection payments under the Federal Transit Act. Overall, excess labor compensation was approximately $8 million. During the same period, overall RTD costs dropped approximately $150 million, after accounting for the excess labor compensation payments.

Las Vegas: Las Vegas is the only major US metropolitan area in which all service is operated through competitive contracting. This was possible because as late as the early 1990s, there had been no publicly subsidized transit system in Las Vegas. Some services

were provided by a franchised private operator principally in the casino corridor ("Las Vegas Strip"). Clark County established a transit system and determined to competitively tender the service. Ridership has grown at a rate unprecedented virtually anywhere else in the high-income world.

The former private operator served 10 million trips in its final year of operation. Today, Citizens Area Transit carries approximately 50 million passengers per year. From 1990 to 2000, the US Census reported that the Las Vegas metropolitan area had experienced by far the greatest increase in transit work trip market share, 100 percent. This was a particularly significant development, since Las Vegas was also the fastest growing major metropolitan area in the nation. Moreover, costs have been comparatively low. In 2001, operating costs per vehicle hour were the lowest among the 36 transit authorities operating more than 1,000,000 vehicle hours, and 41 percent below the average.

Other Areas: In other areas, competitive contracting has tended to be implemented by suburban jurisdictions seeking to obtain more service for the available funding than would be possible if the larger, central transit agency operated the service non-competitively. For example:

- **Los Angeles:** Los Angeles began competitively contracting services in the middle 1980s. By 2001, more than 900 buses were operating under competitive contracts, nearly 25 percent of service. Competitive contracting operating costs per vehicle hour in 2001 were approximately 45 percent below the rate for services produced in-house.

- **Seattle:** For more than 15 years, Snohomish County has competitively contracted an express bus network that principally feeds downtown Seattle and the University of Washington from the northern suburbs. This service had previously been provided by the Seattle transit agency under a negotiated contract. Nearly 100 buses are operated, at costs 41 percent below that of the agency's in house service and 38 percent below the cost of the Seattle transit agency service.

- **San Francisco:** A number of transit agencies competitively contract service in the San Francisco Bay area (15 percent of service). The largest contract is administered by San Mateo County Transit, with services operating into downtown San Francisco. This includes what may be the only competitively contracted service in the nation using articulated buses. Competitively contracted costs were 44 percent lower than internal costs in 2001.

- **Washington:** A number of systems use competitive contracting in the suburbs of Maryland and Virginia. In 2001, competitively contracted costs per vehicle hour were 36 percent below the costs of the central transit agency.

- **Minneapolis-St. Paul:** Approximately 17 percent of bus service is competitively contracted in the Minneapolis-St. Paul area. In 2001, competitive contracting costs per vehicle hour were 30 percent below in-house costs.

Private Sector Participation in Passenger Rail

With annual operating loses averaging about a billion dollars a year, slightly less than revenue earned through ticket sales, Amtrak has required ever escalating federal and state subsidies to maintain the existing level of services. In response to these costly subsidies, some in Congress and the Administration have introduced legislation in recent years that would require or encourage Amtrak to use competitive contracting to provide many of its services, including the operation of an entire route. Although these reform proposals have varied somewhat year to year, those introduced by Rep. John Mica (R-FL) and Senator John McCain (R-AZ) would require Amtrak to implement some of the privatization techniques that Great Britain, Japan, Australia, Argentina, Sweden, Germany and New Zealand have applied with varying degrees of success beginning in the 1990s.

Japan, for example, began the privatization in the mid-1980s in response to soaring costs and subsidies. By the time privatization began in earnest, the Japanese passenger rail service had accumulated roughly $600 billion in debt. After selling off portions of its passenger rail system, these privatized segments are now operating at a profit. Also in the 1990s, Australia and New Zealand privatized passenger rail service. Sweden has contracted out commuter rail service, and Germany is in the process of doing so in several of its metropolitan areas.

In reforming their inefficient rail systems, both Great Britain and Argentina adopted the "concession" or franchise approach under which the government maintains an ownership interest in the system but "sells" the right to operate service over specific routes for specific intervals of time. Private operators compete for these route rights by offering the highest lease payment, or the lowest subsidy. Britain's rail privatization remains one of the most controversial of them all, and while many improvements have occurred, it has not been without increased subsidy costs and a number of significant restructurings and adjustments to the original plan.

On the positive side, British passenger rail service in 2003 experienced its highest level of "passenger kilometers traveled", which at 40.1 billion is the highest level since 1947. Moreover, passenger kilometers traveled rose 40 percent since 1994/95, the year the rail privatization program was implemented. When measured by passenger boardings, 2003's one billion plus boardings was the highest since 1961. Despite a widely publicized fatal accident in 2000 and the subsequent disruption in service that occurred in its aftermath as new safety measures were implemented, passenger boardings continued to increase during the fiscal year 2000-01. Significantly, the number of fatal train accidents per year is lower after privatization than before, and worker fatalities have also fallen. A 2003 report by a professor at University College London contends that in the nine years after privatization, passenger fatalities totaled 97, while in the nine years preceding privatization, passenger fatalities totaled 127. On the negative side, the road

bed privatization (RailTrak) was effectively withdrawn, and public subsidies to the system have increased since privatization.

While these transformations from public control to private sector contracting have not been without their problems, where it has been applied, costs have generally been reduced, losses sometimes turned to profits, service improved, and ridership increased. Even in Britain, where early mistakes on the nature of the infrastructure transfer contributed to a variety of service problems, the Labor Party Government, which inherited the newly privatized system from Conservative Party privatizers, has shown no inclination to reverse course.

Although much of the current discussion of rail privatization trends focus on recent activities occurring abroad, it should be remembered that the first successful rail privatization (and largest privatization up until that time) occurred in 1987 in the United States when the federal government sold its 85 percent ownership stake in the freight railroad Conrail to private investors for a combined payment of $1.9 billion. As a result of the application of better management following its privatization, Conrail's value increased more than five fold between 1987 and 1998 when it was acquired by CSX and Norfolk Southern for $10.3 billion.

Some contend that Amtrak would not receive the same level of investor interest as Conrail or as did the systems in Europe and Asia that were privatized, but there is every reason to believe that many serious proposals from qualified bidders would be received if the federal government expressed an equally serious interest in such proposals.

****

The Heritage Foundation is a public policy, research, and educational organization operating under Section 501(C)(3). It is privately supported, and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2003, it had more than 200,000 individual, foundation, and corporate supporters representing every state in the U.S. Its 2003 income came from the following sources:

Individuals	52%
Foundations	19%
Corporations	8%
Investment Income	18%
Publication Sales and Other	3%

The top five corporate givers provided The Heritage Foundation with 5% of its 2003 income. The Heritage Foundation's books are audited annually by the national accounting firm of Deloitte & Touche. A list of major donors is available from The Heritage Foundation upon request.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own, and do not reflect an institutional position for The Heritage Foundation or its board of trustees.